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FEDERAL GIFT AND ESTATE TAX LAWS

As Congress assembled last January, there was eager anticipation among tax practitioners and others who follow changes to the tax law that we would get new legislation giving us permanent rules with respect to the Federal Estate Tax. As we have told you each year for a number of years, the rules we have in place are temporary and are scheduled to expire at the end of 2009. As it currently stands, 2010 is an estate tax free year, but the estate tax is scheduled to reappear at the stroke of midnight on December 31, 2010, meaning we would go back to the $1,000,000 exemption in effect prior to 2004. Obviously, this possibility is unsettling to those of us who try to do tax planning, and we were awaiting the resumption of the Senate's legislative session in early September. Of course, the budget deficits caused by the war, as well as Hurricanes Katrina followed by Rita and Wilma in close secession, have made it politically impossible to make permanent the tax cuts the administration had proposed. Since 2006 is a Congressional election year, there is little hope that the estate tax issue will be addressed prior to the 2007 legislative session. So as best we can tell, the Federal Gift Tax exemption will remain at $1,000,000 and the Estate Tax and Generation-Skipping Transfer Tax exemptions will increase to $2,000,000 in January, as provided under the current law. Another automatic increase to $3.5 million dollars is scheduled for January 1, 2009, but few people expect we will get to that point without further legislation. Unfortunately, for now we have to repeat what we have been saying for many years, "Stay tuned".

One small piece of good news to report:

An additional automatic increase in tax exemption takes effect in January 1, 2006 when the Gift Tax annual exclusion amount increases from $11,000 to $12,000 per person.

INCREASED INCOME TAX CHARITABLE DEDUCTION LIMITS

In an effort to increase gifts made to benefit victims of the various Hurricanes, Congress has temporarily increased limits on income tax charitable deductions for an individual's cash contributions made between August 28, 2005 and December 31, 2005 to a public charity (other than a supporting organization such as community foundation or a donor advised fund). The increased deduction applies to gifts to all public charities, not just those involved in hurricane relief efforts, but the gift must be in cash in order to qualify for the increased limits. In order for corporations to increase their normal income charitable deduction limits, their gifts must, however, be for hurricane relief. The Hurricane Relief Act provides a unique opportunity for donor's who are over 59½ and who would like to withdraw monies from their IRA in order to make cash gifts to charity. Under normal tax rules, the major drawback faced by a donor who wishes to contribute IRA funds to charity comes from the percentage limitations normally in effect. For example, if a donor were to withdraw $100,000 from his IRA, the donor realizes a $100,000 increase in his income, but upon contributing that entire amount to charity, his deduction is limited to 50% of his adjusted income (this new $100,000 plus his other income). Where the amounts withdrawn are large, some of the

deduction is lost and has to be carried over, such that the donor must pay tax on part of the IRA withdrawal, even though the money is given to charity. Because the Hurricane Relief Act allows a 100% limitation for cash gifts made in the last part of 2005, this particular problem is avoided. We urge you to proceed with caution, however, because other problems may be caused by an increase in your adjusted gross income, such as the fact that your itemized deductions are reduced when your adjusted gross income rises above a certain amount. You also need to be careful of the alternative minimum tax rules that may affect the deductibility of your contribution. Check with your income tax preparer before making any large withdrawals to make sure that you can use the deduction to the fullest extent.

LEGISLATIVE CHANGES AFFECTING ESTATES AND TRUSTS

As you know, the Texas Legislature was in session this past summer, and it passed a number of provisions amending the Texas Trust Code. They primarily affect the way a Trustee determines whether trust receipts are considered to be income or principal. This can be important because many Wills and trusts provide for mandatory "income distributions" to beneficiaries. The major change occurs in the oil and gas area, where a Trustee is allocating receipts from royalties and working interests between principal and income. For those of you administering trusts with oil and gas interests (or for those of you whose estates include significant oil and gas interests), you may wish to contact us concerning how these provisions might affect the trusts you are administering or are creating under your Wills.

Further changes to the Texas Trust Code give "first tier" beneficiaries rights to demand an accounting and impose duties on the Trustee to keep such beneficiaries informed as to the condition of the trust. So called "first tier" beneficiaries are those who either are entitled or permitted to receive current distributions from the trust or who would receive a portion of the trust property if the trust were to terminate at this time. For example, if a trust provides for distributions to a child for his or her lifetime and at the child's death the trust property passes to his or her children, then both the child and the grandchildren are considered to be "first tier" beneficiaries who are entitled to receive annual information concerning the trust. Unfortunately, as passed, these disclosure rules cannot be waived by the person creating the trust. It is hoped that the Legislature will reconsider the ability of the Trustor (person creating the Trust) to absolve the Trustee from the requirement to provide information to persons other than current income beneficiaries when the Legislature reconvenes in 2007. In the meantime, if you are currently acting as a Trustee, we would be pleased to consult with you concerning these disclosure requirements.

FAMILY LIMITED PARTNERSHIPS: THE DEVIL IS IN THE DETAILS

Three recent cases serve to remind us that bad things happen when you fail to observe the formalities of a family limited partnership (FLP). In the Koby Estate, Abraham Estate and Strangi Estate cases, the Tax Court ruled that assets transferred to a family limited partnership should be included in the deceased partner's estate where partnership assets were used by the deceased partner or on his or her behalf to pay such things as living expenses, funeral expenses, estate administration expenses, specific bequests and personal debts of the deceased partner. The message from these cases is clear: always observe the formality of the FLP arrangement. Do not retain actual possession or use of partnership property without reimbursing the partnership. Be careful about making distributions from the FLP and do not use FLP assets to pay personal expenses. Failure to follow these rules will result in the partnership property being included in your estate.

HAPPY HOLIDAYS AND BEST WISHES FOR A PROSPEROUS 2006!